

STATE OF SOUTH CAROLINA

(Caption of Case)

IN RE: Joint Application of Frontier
Communications Corporation, New
Communications of the Carolinas, Inc.,
New Communications Online, and Long
Distance, LLC, and Verizon Enterprise
Solutions LLC for Approval of the Sale of
Assets and the Transfer of Authority and
Certificates

BEFORE THE
PUBLIC SERVICE COMMISSION
OF SOUTH CAROLINA

COVER SHEET

DOCKET
NUMBER: 2009 - 220 - C

(Please type or print)

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DOCKETING INFORMATION (Check all that apply)

☐ Emergency Relief demanded in petition

☐ Request for item to be placed on Commission's Agenda expeditiously

☒ Other: Testimony

INDUSTRY (Check one)	NATURE OF ACTION (Check all that apply)			
<input type="checkbox"/> Electric	<input type="checkbox"/> Affidavit	<input type="checkbox"/> Letter	<input type="checkbox"/> Request	
<input type="checkbox"/> Electric/Gas	<input type="checkbox"/> Agreement	<input type="checkbox"/> Memorandum	<input type="checkbox"/> Request for Certification	
<input type="checkbox"/> Electric/Telecommunications	<input type="checkbox"/> Answer	<input type="checkbox"/> Motion	<input type="checkbox"/> Request for Investigation	
<input type="checkbox"/> Electric/Water	<input type="checkbox"/> Appellate Review	<input type="checkbox"/> Objection	<input type="checkbox"/> Resale Agreement	
<input type="checkbox"/> Electric/Water/Telecom.	<input type="checkbox"/> Application	<input type="checkbox"/> Petition	<input type="checkbox"/> Resale Amendment	
<input type="checkbox"/> Electric/Water/Sewer	<input type="checkbox"/> Brief	<input type="checkbox"/> Petition for Reconsideration	<input type="checkbox"/> Reservation Letter	
<input type="checkbox"/> Gas	<input type="checkbox"/> Certificate	<input type="checkbox"/> Petition for Rulemaking	<input type="checkbox"/> Response	
<input type="checkbox"/> Railroad	<input type="checkbox"/> Comments	<input type="checkbox"/> Petition for Rule to Show Cause	<input type="checkbox"/> Response to Discovery	
<input type="checkbox"/> Sewer	<input type="checkbox"/> Complaint	<input type="checkbox"/> Petition to Intervene	<input type="checkbox"/> Return to Petition	
<input checked="" type="checkbox"/> Telecommunications	<input type="checkbox"/> Consent Order	<input type="checkbox"/> Petition to Intervene Out of Time	<input type="checkbox"/> Stipulation	
<input type="checkbox"/> Transportation	<input type="checkbox"/> Discovery	<input checked="" type="checkbox"/> Prefiled Testimony	<input type="checkbox"/> Subpoena	
<input type="checkbox"/> Water	<input type="checkbox"/> Exhibit	<input type="checkbox"/> Promotion	<input type="checkbox"/> Tariff	
<input type="checkbox"/> Water/Sewer	<input type="checkbox"/> Expedited Consideration	<input type="checkbox"/> Proposed Oder	<input type="checkbox"/> Other: _____	
<input type="checkbox"/> Administrative Matter	<input type="checkbox"/> Interconnection Agreement	<input type="checkbox"/> Protest		
<input type="checkbox"/> Other: _____	<input type="checkbox"/> Interconnection Amendment	<input type="checkbox"/> Publisher's Affidavit		
	<input type="checkbox"/> Late-Filed Exhibit	<input type="checkbox"/> Report		

OK D. Duke
OK D. Duke

August 6, 2009

Charles L.A. Terreni
Chief Clerk & Administrator
Public Service Commission of South Carolina
PO Drawer 11649
Columbia, SC 29211

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2009-08-06 PM 1:17
Reply to: Columbia
Direct: 803-576-3714
PUBLIC SERVICE
COMMISSION

Re: Joint Application of Frontier Communications Corporation, New Communications of the Carolinas, Inc., New CommunicationsOnline And Long Distance LLC and Verizon Enterprise Solutions LLC for Approval of the Sale of Assets and the Transfer of Authority and Certifications

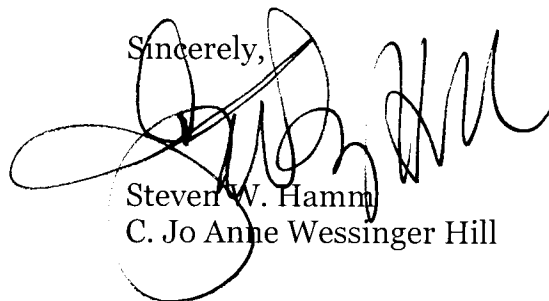
Dear Mr. Terreni:

Please find attached the original Pre-Filed Rebuttal Testimony of Timothy McCallion on behalf of New Communications of the Carolinas Inc., New Communications Online and Long Distance Inc., Verizon South Inc. ("Verizon South"), Verizon Long Distance Inc. ("VLD"), and Verizon Enterprise Solutions LLC ("VES") (collectively, "Verizon").

By copy of this letter, the Rebuttal Testimony is being provided to counsel and/or parties of record.

With kindest regards, I am

Sincerely,



Steven W. Hamm
C. Jo Anne Wessinger Hill

SWH/JWH:kjt
Enclosures

Cc: C. Dukes Scott, ORS, Executive Director
Nanette S. Edwards, ORS Chief Counsel and Director of Legal Services
M. John Bowen, Jr., Esq.
Margaret M. Fox, Esq.
Sue-Ann Gerald Shannon, Esq.
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De O'Roark, Esq.
Kevin Saville, Esq.

BEFORE
THE PUBLIC SERVICE COMMISSION
OF SOUTH CAROLINA
DOCKET NO. 2009-220-C

RECEIVED
PUBLIC SERVICE
COMMISSION
JAN 13 2010

IN RE: Joint Application of Frontier
Communications Corporation, New
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Distance Inc., Verizon South Inc., Verizon
Long Distance Inc. and Verizon Enterprise
Solutions LLC for Approval of the Sale of
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**REBUTTAL TESTIMONY OF
TIMOTHY MCCALLION**

1

2 **Introduction**

3 **Q. Are you the same Timothy McCallion who provided direct testimony in this docket?**

4 A. Yes.

5

6 **Q. On whose behalf are you offering testimony?**

7 A. My testimony is offered on behalf of New Communications of the Carolinas Inc.
8 ("NewILEC"), New Communications Online and Long Distance Inc. ("NewLD"),
9 Verizon South Inc. ("Verizon South"), Verizon Long Distance Inc. ("VLD") and Verizon
10 Enterprise Solutions LLC ("VES").

11

12 **Q. Please describe the purpose of your rebuttal testimony.**

1 A. The purpose of my rebuttal testimony is to respond to certain claims by Charles W. King,
2 who submitted testimony on behalf of the Department of Defense representing all Federal
3 Executive Agencies (“DoD/FEA”). I will explain that Mr. King has overstated
4 DoD/FEA’s interest in this case; that the transaction at issue (the “Transaction”) differs
5 substantially from the Hawaiian Telecom and FairPoint transactions discussed by Mr.
6 King; and that conditions recommended by Mr. King should not be imposed.

7
8 **DoD/FEA’s Alleged Interests**

9 **Q. Mr. King asserts that DoD/FEA has a vital interest in this case, in part because of its**
10 **“numerous and varied locations throughout South Carolina.” Does the Transaction**
11 **involve the transfer of assets throughout the state?**

12 A. No, the Transaction only involves the transfer of assets in Verizon South’s service
13 territory in South Carolina, which encompasses a relatively small portion of the state. As
14 discussed in my Direct Testimony, Verizon South serves approximately 128,000 access
15 lines in South Carolina.

16
17 **Q. What services do Verizon companies provide to DoD/FEA in the Verizon South**
18 **service area in South Carolina and what effect, if any, will the Transaction have on**
19 **the provision of those services?**

20 A. MCI Communications Services, Inc. d/b/a Verizon Business Services (“Verizon
21 Business”) provides long distance voice, Internet and data services to Shaw Air Force
22 Base in Verizon South’s service area through the FTS2001 contract, which is a large
23 multiple-award agreement managed by the General Services Administration for domestic

1 and international telecommunications services. All federal agencies in the Verizon South
2 service territory, including military and civilian agencies, can purchase services under
3 this contract and the follow-on Networx Universal and Networx Enterprise contracts,
4 which also provide terms for long distance voice, Internet and data services. Verizon
5 Business will continue to provide service under these contracts after the Transaction
6 closes. In addition, Verizon South may provide services to federal agencies that elect to
7 take service under Verizon South's tariffs or generally available offerings. Verizon
8 South provides local service to Shaw Air Force Base on this basis. After the Transaction,
9 a Verizon company, if DoD/FEA desires to take service from Verizon, will provide these
10 services using the same facilities.

11
12 In short, after the Transaction closes, DoD/FEA will continue to receive services under
13 its national contracts from Verizon Business and will be able to receive other services
14 from a Verizon company on a resale or similar basis using the same facilities Verizon
15 South now uses to provide those services. The Transaction therefore will have little or no
16 effect on DoD/FEA.

17
18 **Q. Does the Commission regulate the services the Verizon companies provide to**
19 **DoD/FEA under contract?**

20 **A.** No. My understanding is that the Commission does not regulate such services.

21
22 **Q. Mr. King claims that DoD/FEA's interest goes beyond the federal locations in**
23 **Verizon South's service territory because it procures services through competitive**

1 **bidding, which he asserts could be affected by the Transaction. Does Mr. King raise**
2 **a valid concern?**

3 A. No. DoD/FEA procures long distance voice, Internet and data service through a *national*
4 competitive bidding process in which bidders compete to provide services on a national
5 basis. This national bidding process will not be affected by the Transaction in South
6 Carolina.

7
8 Nor will the bidding process for the provision of local voice service be affected. After
9 the Transaction, Frontier Communications Corporation (“Frontier”) will be positioned as
10 a strong local service provider in a highly competitive market in South Carolina for the
11 provision of business and government services. The Transaction will not decrease the
12 level of competition for local services in South Carolina.

13
14 **Previous Transactions**

15 **Q. Mr. King asserts that two previous Verizon transactions should concern the**
16 **Commission. Is this Transaction different from ones where post-transaction**
17 **problems have occurred?**

18 A. Yes, very different. The two transactions Mr. King discusses are Verizon’s sale of
19 control of its Hawaii operations to The Carlyle Group in 2005, and the spin/merger of
20 certain of its New England operations to FairPoint Communications, Inc. last year. As
21 explained in more detail below, both of those transactions are fundamentally different
22 than the proposed Transaction. Each of those transactions involved the creation of
23 entirely new operational and back-office systems created by third-party vendors, a

1 lengthy post-closing “transition” period in which Verizon continued to use its own
2 systems to operate much of the buyer’s business while the new systems were developed,
3 and finally a complex “flash cut” to the new systems. None of those complications will
4 be present in this Transaction in South Carolina. Moreover, Frontier is a large,
5 experienced operating company and that will help ensure a smooth transition.

6
7 **Q. Please summarize the problems FairPoint experienced post-transaction, and please**
8 **explain why this Transaction is different.**

9 A. Based on publicly available information, FairPoint encountered operational problems
10 with the new systems it had designed and built by a third-party vendor to completely
11 replace Verizon’s systems and to run the businesses it acquired. These problems –
12 primarily related to billing processes, order flow, and call center response for both retail
13 and wholesale operations. Those operational problems have translated into increased
14 costs for manual processing of orders, lost billing cycles for customers whose service
15 orders were delayed, and possibly some customer attrition.

16
17 The circumstances here are entirely different. First, the FairPoint transaction involved a
18 cutover to a completely new set of systems that FairPoint had contracted a third-party
19 vendor to develop specifically for the transaction (and that FairPoint and its contractor
20 were still developing and testing well past the closing and right up to the cutover). In
21 contrast, the proposed Transaction does not involve newly developed systems, a
22 comparable transition service period or a complex cutover for South Carolina. FairPoint
23 replaced hundreds of Verizon systems with 60 wholly new systems developed by

1 FairPoint and its contractor to support its new business. Those brand-new systems then
2 had to be populated with data provided by Verizon at cutover and then brought online.
3 Unlike FairPoint, Frontier will take possession of a tested functional replication of
4 Verizon's existing systems at closing for operations in all states (other than West Virginia
5 which is not relevant here). If Frontier chooses to transition systems at some point in the
6 future, it can do so at its own pace and with a focus on phasing in capabilities for specific
7 customer groups.

8
9 Second, as discussed above, Frontier has a successful track record of integrating the
10 operations of various operating companies, including its acquisition of Commonwealth
11 Telephone in 2006, which involved some 316,000 access lines. Frontier already has
12 existing, proven systems – and Frontier's existing systems are fully scalable.

13
14 Finally, as discussed in Mr. McCarthy's Direct Testimony, Frontier is now a large,
15 strong, conservatively capitalized company whose balance sheet will become stronger
16 after the Transaction.¹

17
18 **Q. Please summarize the problems Hawaiian Telecom experienced post-transaction, and**
19 **please explain why this Transaction is different.**

20 **A.** An entity affiliated with The Carlyle Group, a private equity investment firm,
21 consummated the acquisition of Hawaiian Telecom ("HTL") in May 2005, following the

¹ Frontier's current debt-to-EBITDA ratio of 3.8 is expected to improve to 2.6 after the transaction is completed.

1 announcement of the bid in May 2004. HTL has described its post-transaction problems
2 as follows:

3 On April 1, 2006, we cut over from the legacy Verizon systems to our new
4 back-office and IT infrastructure. While the major network operational
5 systems functioned without significant problems, critical systems related to
6 back-office functions, such as customer care, order management, billing,
7 supply chain, and other systems interfacing with our financial systems,
8 lacked significant functionality. This led to deficiencies in order accuracy,
9 service provisioning, billings and collections, revenue assurance and overall
10 customer service. Despite efforts to improve the functionality of the related
11 systems since 2006, we continued to experience many of these same issues,
12 requiring us to incur significant incremental expenses to retain third-party
13 service providers to provide call center and manual processing services in
14 order to operate our business.²

15
16 As a result of the operational problems described above, and other business challenges,
17 HTL eventually filed for bankruptcy in 2008.

18
19 The differences between the proposed Transaction and the HTL transaction are
20 essentially the same as the differences referenced concerning FairPoint – but even more
21 pronounced. The Carlyle Group was (i) not an operating company with extensive
22 experience in the telephone business, and (ii) its business plan was based on outsourcing
23 the development of brand new systems to a third-party vendor and to expeditiously end
24 its use of the Verizon systems to reduce costs once those systems were developed.
25 Neither of these characteristics applies to the Frontier Transaction. Moreover, HTL's
26 first system developer was replaced, but the systems development problems continued
27 long after the transaction closed. Frontier, on the other hand, is an experienced and
28 sophisticated telephone company – it has significant experience in operations support

² See Hawaiian Telcom Communications, Inc.'s 10-Q for period ending September 30, 2008.

1 systems, and if it decides to replace or modify any of its systems, it is confident that it can
2 do so at an appropriate time.

3
4 **Q. Do these previous transactions justify the conditions that Mr. King recommends?**

5 A. No. For the reasons I have just discussed, those transactions do not provide any basis for
6 imposing any conditions on the Transaction.

7
8 **Conditions Requested by DoD/FEA**

9 **Q. Does DoD/FEA oppose the Transaction?**

10 A. No. Mr. King states that DoD/FEA does not necessarily oppose the Transaction. He
11 further states that the Transaction should be in the public interest if the Commission
12 adopts certain conditions that he recommends.

13
14 **Q. As a preliminary matter, do the conditions DoD/FEA requests relate to the relief
15 being sought in this case?**

16 A. No. As I noted in my Direct Testimony, the Joint Applicants are requesting Commission
17 approvals relating to an internal reorganization within Verizon before the final transfer of
18 NewILEC and NewLD to Frontier. The conditions DoD/FEA seeks all relate to the
19 transfer of control of NewILEC and NewLD from Verizon to Frontier, which will take
20 place at the parent company level and my understanding is that this transfer therefore is
21 not subject to Commission approval.

22

1 **Q. What conditions recommended by Mr. King do you discuss below?**

2 A. I will discuss conditions Mr. King proposes relating to rates caps, service quality and
3 employee benefit programs. Mr. McCarthy also addresses the conditions that Mr. King
4 recommends.

5
6 **Q. Mr. King recommends that if NewILEC's basic residential and small business**
7 **(single or double line) rates increase by more than 10 percent in a given year, the**
8 **Commission should convene a rate cap proceeding. Should this recommendation be**
9 **adopted?**

10 A. No. South Carolina already has rate caps in place for these services for companies like
11 Verizon South that are subject to alternative regulation. For flat-rated local exchange
12 services for residential and single-line business customers, Verizon South's prices are
13 subject to an inflation-based rate cap under S.C. Code § 58-9-576(4). The aggregate
14 increases in the tariffed rates for other services may not exceed five percent of the
15 aggregate revenues from tariffed other services during the prior 12-month period. S.C.
16 Code § 58-9-576(5).

17
18 **Q. Would these rate caps apply to NewILEC?**

19 A. Yes. NewILEC has requested that the Commission transfer Verizon South's
20 authorization to provide local exchange service in South Carolina to NewILEC, subject to
21 alternative regulation, or, alternatively, that the Commission grant NewILEC a certificate
22 of public convenience and necessity to provide local exchange service in the areas that
23 currently are served by Verizon South, subject to alternative regulation.

1 **Q. Mr. King also recommends that the Commission adopt new service quality metrics,**
2 **standards and remedies that would apply exclusively to NewILEC after it is**
3 **acquired by Frontier. Is this recommendation sound?**

4 **A. No. This recommendation should be rejected for several reasons.**

5
6 First, there is no basis for adopting additional metrics, standards and remedies that apply
7 solely to NewILEC. Verizon South's service quality reports that it submits to the
8 Commission quarterly show that it has met the Commission's standards for the reported
9 metrics for the last 12 months. As discussed above, after the Transaction, NewILEC will
10 take possession of the same systems that Verizon currently uses. Also, most of the
11 Verizon employees who today are involved in the day-to-day provisioning and
12 maintenance of service to customers of Verizon South will continue as NewILEC
13 employees. Therefore, NewILEC will be well-positioned to continue to provide
14 telephone service that meets South Carolina's service quality standards. The
15 Commission should not adopt new metrics, standards and reporting requirements for
16 NewILEC based on speculation about its future performance.

17
18 Second, the Commission reviewed and amended its service quality regulations in 2006
19 and thus has given recent consideration to the appropriate level of service quality
20 regulation in the state. The additional metrics, standards and remedies proposed by Mr.
21 King would represent an exponential increase in regulation, far beyond what the
22 Commission has deemed appropriate.

1 Third, the Commission should not single out NewILEC for extensive new service quality
2 regulation that would not apply to its competitors and other ILECs. Making NewILEC
3 the only telecommunications service provider in the state that would be subject to such
4 regulations would be discriminatory, and would put it at a substantial competitive
5 disadvantage.

6
7 **Q. Mr. King asserts that Verizon should be required to fully fund its pension and**
8 **retiree health programs before Frontier assumes liabilities associated with those**
9 **programs. Should such a condition be imposed?**

10 A. No. Although I am not a lawyer, I am not aware of any law that gives the Commission
11 authority to impose such a condition. Also, in negotiating the Transaction, the parties
12 took into account many different terms and conditions; Mr. King would have the
13 Commission change the terms of the deal based on one isolated aspect of the Transaction
14 – an aspect over which DOD has no conceivable interest. The Commission should reject
15 Mr. King’s proposal.

16
17 Furthermore, our *preliminary* South Carolina employee count, pending any realignment
18 of employees, is 177 associates and 40 management employees as of July 31, 2009. This
19 is a very small number of employees given the total size of the Transaction.

20

1 **Q. What Verizon pension plans cover Verizon South employees in South Carolina?**

2 A. There are two tax-qualified pension plans that cover most South Carolina employees: the
3 GTE South Incorporated Plan for Hourly-Paid Employees Pensions (“Hourly-Paid
4 Plan”); and the Verizon Management Pension Plan (“Management Plan”).

5
6 **Q. Were the Verizon Hourly-Paid Plan and the Management Plan fully funded as of**
7 **December 31, 2008?**

8 A. The Hourly-Paid Plan, which covers the majority of the South Carolina employees, was
9 fully funded as of December 31, 2008 and the Management Plan was funded at about
10 84% as of that date. This information is based on the most recent Annual Funding
11 Notices that were distributed to participants this past April.

12
13 **Q. Does the parties’ agreement address the transfer of pension assets and liabilities for**
14 **the tax-qualified pension plans?**

15 A. Yes. Under the parties’ Employee Matters Agreement (EMA), the assets to be
16 transferred to the successor Frontier tax-qualified pension plans must, in the aggregate, be
17 sufficient to fully fund the plans’ aggregate projected liabilities from an accounting
18 perspective. If the aggregate assets transferred from each of the individual plans based
19 on the Internal Revenue Code rules are less than the aggregate projected benefit liabilities
20 from an accounting perspective (determined as of the closing of the merger), then
21 Verizon will pay to Frontier or to the new Frontier pension plans an amount equal to such
22 underfunding. If this amount is paid to Frontier, Frontier must contribute that amount to
23 one or more of the underfunded pension plans. The assumptions and methods governing

1 the pension asset transfers are set forth in the EMA and Exhibit A thereto. (As noted in
2 the EMA, Verizon has committed to provide Frontier pension assets at least equal to the
3 aggregate Projected Benefit Obligation (“PBO”) for all transferred employees in the
4 pension plans from which there will be asset transfers. The PBO is intended to reflect the
5 amount of pension liability on a “going-concern” basis, and this EMA provision means
6 that Verizon will likely transfer an amount above and beyond what is required by the IRS
7 rules.)

8
9 Finally, although certain individual Verizon tax-qualified plans, by themselves, have
10 different funded levels, the bottom line is that under the parties’ agreement, Verizon must
11 fully fund, in the aggregate, the projected benefits of all tax-qualified plans determined as
12 of the closing date.

13
14 **Q. How will employees’ 401(k) plans be treated under the Transaction?**

15 A. Frontier will establish defined contribution plans providing for 401(k) contributions and
16 employer matching contributions for former Verizon management employees who
17 become active NewILEC employees, and for former Verizon employees covered by a
18 collective bargaining agreement who become NewILEC employees. Each such plan will
19 be identical in all material respects to the applicable Verizon 401(k) plan that covered the
20 affected Verizon employees prior to the merger.

1 **Q. How will retiree health programs be handled?**

2 A. Verizon employees who retire before closing will receive any retiree benefits to which
3 they are entitled through Verizon. Verizon's pre-funding for retiree medical benefits is
4 quite limited (approximately 10%), and benefit obligations are paid primarily
5 (approximately 80%) on a "pay-as-you-go" basis from company assets.

6
7 Under the parties' agreements, Verizon will not transfer assets from this limited fund to
8 Frontier for retiree medical benefits for Verizon employees who continue their
9 employment with Frontier and then retire. Frontier will be responsible for determining
10 whether to establish a trust to fund such benefits or pay them out of company assets on a
11 "pay-as-you-go" basis.

12
13 **Q. Does this conclude your rebuttal testimony?**

14 A. Yes.

**BEFORE
THE PUBLIC SERVICE COMMISSION
OF SOUTH CAROLINA**

DOCKET NO. 2009-220-C

IN RE: Joint Application of Frontier Communications Corporation, New Communications of the Carolinas, Inc., New CommunicationsOnline, and Long Distance, LLC, and Verizon Enterprise Solutions LLC for Approval of the Sale of Assets and the Transfer of Authority and Certificates

CERTIFICATE OF SERVICE

I, the undersigned, an employee of Richardson, Plowden & Robinson, P. A., attorneys for New Communications of the Carolinas Inc., New Communications Online and Long Distance Inc., Verizon South Inc. ("Verizon South"), Verizon Long Distance Inc. ("VLD"), and Verizon Enterprise Solutions LLC ("VES") (collectively, "Verizon"), do hereby certify that I have served the foregoing Pre-Filed Rebuttal Testimony of Timothy McCallion on behalf of and its attachments by causing it to be deposited in the U.S. mail, postage prepaid, or by hand delivery, on this 6th day of August, 2009, to the following:

**Nanette S. Edwards,
Chief Counsel and Director of Legal
Services
S.C. Office of Regulatory Staff
1401 Main Street, Suite 900
Columbia, SC 29201**

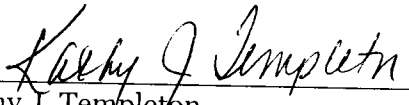
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Kathy J. Templeton

Dated: August 6, 2009